No. 83-614

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION,

Petitioner,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF PETITIONER SECURITIES INDUSTRY ASSOCIATION

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QUESTIONS PRESENTED

At issue is a decision of the Court of Appeals upholding a ruling of the Federal Reserve Board. That decision permits the largest bank holding company in the United States to acquire the nation's largest discount broker and thereby to engage in public securities brokerage—a business no bank affiliate has conducted since federal restrictions on bank securities activities were enacted in the wake of the national banking crisis fifty years ago. The specific questions are:

1. Did the Court of Appeals err in affirming a Federal Reserve Board ruling that a nonbanking activity, here public securities brokerage, is "so closely related to banking . . . as to be a proper incident thereto" within the meaning of the Bank Holding Company Act, where the activity is not one traditionally performed by banks, or even one that supports a banking activity, but is only "functionally similar" to some banking operations?

2. Did the Court of Appeals err in affirming a Federal Reserve Board ruling that the flat prohibitions of the Glass-Steagall Act restricting both direct and indirect securities activities of banks need not be construed consistently, so that, depending upon an administrative view of the risks posed, a bank affiliate may be authorized to engage principally in securities activities that are barred entirely to banks?

PARTIES TO THE PROCEEDING

In addition to the petitioner* and respondents listed in the caption, the following are also respondents in this action: Paul A. Volcker as Chairman of the Board of Governors of the Federal Reserve System, Preston Martin, Nancy H. Teeters, J. Charles Partee, Henry C. Wallich, Emmet J. Rice and Lyle E. Gramley, as Members of the Board of Governors of the Federal Reserve System, and BankAmerica Corporation as Intervenor in the proceeding below.

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* Pursuant to Rule 28.1 of this Court, petitioner states as follows: The Securities Industry Association is a national trade association representing more than 500 securities brokers, dealers and underwriters who are responsible for over 90 percent of the securities brokerage and investment banking business in the United States.

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PRELIMINARY STATEMENT

At issue is a decision upholding an Order of the Board of Governors of the Federal Reserve System (the "Board") which approved the application of BankAmerica Corporation ("BAC"), parent of the largest bank in the nation, to acquire the Charles Schwab Corporation ("Schwab"), owner of the nation's largest discount broker. This case is one of a series of recent actions through which bank regulators, who now question the judgments made by Congress in the past, have sanctioned new bank activities by "reinterpreting" existing law.

OPINIONS BELOW

The opinion of the Court of Appeals for the Second Circuit (157A)[1] is reported at 716 F.2d 92. The order of the Board approving the BAC application to acquire Schwab (125A) is reported at 69 Fed. Res. Bull. 105 (1983).

JURISDICTION

The judgment of the Court of Appeals for the Second Circuit was entered on July 15, 1983. A timely Petition for a Writ of Certiorari was granted on January 23, 1984. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

This action concerns two federal statutes designed to restrict the activities of banks and their affiliates:[2]

1. The Bank Holding Company Act, 12 U.S.C. §§ 1841, *et seq.*, broadly prohibits bank holding companies from owning any entity engaged in activities other than banking. 12 U.S.C. § 1843(a). Only limited, expressly defined exceptions are allowed. The one exception relevant here is contained in Section 4(c)(8) of the Act, 12 U.S.C. § 1843(c)(8), which permits a bank holding company to own an entity,

> the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking . . . as to be a proper incident thereto.

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1 Citations to material printed in the Joint Appendix appear as "____A". Citations to material contained in the Joint Appendix before the Second Circuit Court of Appeals appear as "J.A. ____".

2 Relevant statutory provisions are set out at length in the Joint Appendix at 177A-180A.

2. The Glass-Steagall Act,[3] enacted in 1933 and initially amended in 1935, following the collapse of the banking system, restricts banks from engaging directly or indirectly in the securities business. Relevant to this action are Sections 16, 20 and 21 of the Act, 12 U.S.C. § 24 (Seventh), 377 and 378, which provide, in relevant part:

Section 16 *(12 U.S.C. § 24 (Seventh))*:

> The business of dealing in securities and stock by [a national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, ...

Section 20 *(12 U.S.C. § 377)*:

> After one year from June 16, 1933, no member bank shall be affiliated in any manner described in subsection (b) of section 221a of this title with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities.

Section 21 *(12 U.S.C. § 378)*:

> (a) After the expiration of one year after June 16, 1933, it shall be unlawful—
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> (1) For any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits

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3 The Glass-Steagall Act was enacted as part of the Banking Act of 1933, Pub. L. No. 73-66, 48 Stat. 162, and is codified in various sections of Title 12 of the United States Code.

subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor: *Provided*, That the provisions of this paragraph shall not prohibit national banks or State banks or trust companies (whether or not members of the Federal Reserve System) or other financial institutions or private bankers from dealing in, underwriting, purchasing, and selling investment securities, or issuing securities, to the extent permitted to national banking associations by the provisions of section 24 of this title: . . . .

STATEMENT OF THE CASE

A. Background

On March 8, 1982 BAC, parent holding company of the country's largest bank, applied to the Board under Section 4(c)(8) of the Bank Holding Company Act ("Section 4(c)(8)") for permission to acquire Schwab, a company engaged principally in public securities brokerage through its wholly-owned subsidiary, Charles Schwab & Co., Inc. (159A.) Public securities brokerage is a nonbanking activity the Board had never previously found to be permissible for a bank affiliate.[4]

Before BAC announced its plans, no bank or bank holding company had engaged in the securities brokerage business since the passage of the Glass-Steagall Act half a century ago.[5] Within a year after BAC's application, federal bank regulators had taken action to permit *all* of the banking entities under

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4 As Board Counsel acknowledged before the Administrative Law Judge, the BAC application to acquire Schwab was "one of first impression." Post Hearing Brief of Board Counsel at 53 (Oct. 1, 1982), reprinted in the Joint Appendix submitted to the Court of Appeals at J.A. 368.

5 N.Y. Times, Nov. 25, 1981 at D1, col. 6; Wash. Post, Nov. 25, 1981 at D7. *See* Note, *National Banks and the Brokerage Business: The Comptroller's New Reading of the Glass-Steagall Act*, 69 Va. L. Rev. 1303, 1314-15 (1983).

their jurisdiction to enter that business. Aside from the Board's actions, in rapid succession:

— The Federal Home Loan Bank Board authorized the first nationwide joint venture by federally chartered savings and loan associations in approving a thrift-sponsored securities brokerage and investment advisory firm.[6]

— The Comptroller of the Currency, repudiating half a century of his own construction to the contrary, approved public brokerage activities for all national banks.[7]

— The Federal Deposit Insurance Corporation proposed new rules that would permit not only brokerage but securities underwriting by affiliates of all the state chartered banks under its jurisdiction.[8]

Congress, which itself was considering proposals to expand the securities activities of banks, watched with frustration. The Chairman of the Senate Banking Committee publicly described regulatory changes by the banking agencies as "go[ing] to the basic structure of our financial system."[9] A Conference Committee of both Houses of Congress even took the highly

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6 *Decision of the Federal Home Loan Bank Board on the Service Corporation Application of Coast Federal Savings & Loan Association, et al.* (May 6, 1982).

7 *Decision of the Comptroller of the Currency on the Application by Security Pacific National Bank to Establish an Operating Subsidiary To Be Known as Security Pacific Discount Brokerage Services, Inc.* (August 26, 1982).

8 *FDIC Statement of Policy on the Applicability of the Glass-Steagall Act to Securities Activities of Subsidiaries of Insured Non-Member Banks*, 47 Fed. Reg. 38984 (Sept. 3, 1982). *See also* 48 Fed. Reg. 22155, *et seq.* (May 17, 1983).

9 *See* 40 Wash. Fin. Rep. (BNA) No. 21 at 1085 (May 23, 1983).

unusual step in its Report on proposed banking legislation of directing the Federal Home Loan Bank Board that it:

> should not approve, in the absence of clear and specific Congressional authorization, any new regulation expanding activities of [savings and loan subsidiaries]. . . .[10]

In an alarmingly short time, the legislatively mandated line between banking and the securities business had become administratively blurred, if not erased.

B. Proceedings

In response to notice published by the Board (*see* 47 Fed. Reg. 16104 (April 14, 1982)), SIA objected to BAC's application to acquire Schwab and requested an evidentiary hearing. (125A.) The Board scheduled an expedited hearing before an Administrative Law Judge,[11] and, following submission of written statements and rebuttal testimony, a six-day hearing was held for purposes only of cross-examining witnesses who had submitted prepared statements. (126A.)

The subjects of the hearing included the activities of the Applicant, BAC, and its principal subsidiary, BankAmerica N.T. & S.A., as well as the activities of Schwab. BAC is the second largest bank holding company in the United States with total consolidated assets, at the time of the hearing, in excess of $120 billion. (159A.) It is the owner of the largest bank in the United States and is by far the dominant financial institution in California. (127A.)

Schwab, founded in 1971, became a "discount" broker after fixed-rate commissions were eliminated in May 1975. Schwab is the largest discount broker in the United States (158A) and offers its customers an array of services. (159A.) The essence

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10 S. Conf. Rep. No. 97-641, 97th Cong., 2d Sess. 88 (1982).

11 Upon consent, the Department of Justice was permitted to intervene in the proceeding before the Board. (126A.)

of its business is executing securities transactions for its 300,000 customers. (17A.) This transactional business consists almost entirely of executing, for a fee, the purchase and sale of securities (including stocks, bonds and options). Three-quarters of this business is concentrated in the execution of stock transactions (18A; J.A. 174, 300), the majority of which are completed on the New York and American Stock Exchanges.[12]

Following the hearing, briefs were submitted, and the Administrative Law Judge filed a Recommended Decision favoring the acquisition. (5A.) On January 7, 1983, the Board issued its order approving for the first time affiliation between a bank holding company and a securities brokerage firm. (125A.)

The Board recognized in its order that banks had not previously engaged in the sort of retail brokerage business conducted by Schwab (129A) and did not find that Schwab's brokerage business would facilitate banking activities. The Board nevertheless ruled (*id.*) that Schwab's business was "so closely related to banking . . . as to be a proper incident thereto" within the meaning of Section 4(c)(8) because, in its view, the activity is:

> operationally and functionally very similar to the types of brokerage services that are generally provided by banks and that banking organizations are particularly well-equipped to provide such services.

The Board also concluded that BAC's proposed securities brokerage activities were permissible under Section 20 of the Glass-Steagall Act, 12 U.S.C. § 377, even though that Section of the Act prohibits banks from affiliating with organizations "engaged principally" in the "public sale" of securities. (178A.) The Board thought the latter term should be limited to

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12 At the time of the hearing Schwab had two seats on the New York Stock Exchange, one seat on the Chicago Board Options Exchange, two seats on the Pacific Exchange and was represented on the floors of other exchanges. (17A.) *See* Testimony of Schwab President Lawrence J. Stupski at 67, 74 (September 8, 1982).

a technical meaning, referring only to the distribution of "new issues or large blocks" of securities. (148A.) The Board sought to support its conclusion by reference to a 1982 ruling by the Office of the Comptroller of the Currency which reversed fifty years of its own consistent construction that banks are prohibited from engaging in public securities brokerage under Section 16 of the Act, 12 U.S.C. § 24 (Seventh). (150A.)

BAC finalized its acquisition of Schwab two business days after the Board approved the application.[13] SIA petitioned the Court of Appeals for the Second Circuit, under 12 U.S.C. § 1848, to review the Board's unprecedented order.

C. Decision Below

The Court of Appeals, deferring to the Board, accepted its construction of the terms of both the Bank Holding Company Act and the Glass-Steagall Act.

The court below embraced the Board's interpretation that the Section 4(c)(8) prohibition limiting activities to those "so closely related to banking . . . as to be a proper incident thereto," actually authorizes bank affiliates to engage in *any* business that is "functionally similar" to a traditional banking activity. (171A.) The court rejected any construction of Section 4(c)(8) requiring that activities not traditionally performed by banks be undertaken by bank affiliates only in furtherance of a permissible bank activity, the construction previously given the Act by the Fifth Circuit Court of Appeals. (173A-174A.)

Finding the acquisition also to be acceptable under the Glass-Steagall Act, the court below judged it only against the Section 20 restriction on the "public sale" of securities. The court saw no necessity to interpret the interrelated sections of the Act consistently. (167A.) It concluded that Section 20, read in isolation, "reasonably" could be construed not to include securities brokerage among the activities prohibited to bank affiliates. (161A.) In its view, bank affiliates may engage principally in securities activities prohibited entirely to banks,

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13 N.Y. Times, Jan. 12, 1983 at D4, col. 5.

if the Board determines the activity does not present the "dangers" addressed by the Act. (168A.)

Less than one month after the decision below, the Board promulgated new regulations that added securities brokerage to its list of activities generally permitted to bank holding companies.[14]

SUMMARY OF ARGUMENT

This case, one "of first impression" for the Board, involves the admitted "expansion of banking into securities activities." It reflects the recent inclination of banking regulators to sidestep statutory restrictions where they no longer fit the *regulator's* view of what policy should be.

I. The Bank Holding Company Act was intended to stop banks from evading statutory restrictions by use of the bank holding company structure. Section 4(c)(8) of that Act, one of its limited exceptions, permits bank holding companies to acquire nonbank subsidiaries only when those subsidiaries are engaged in a business that is "so closely related to banking . . . as to be a proper incident thereto." Legislative history and court interpretation show that, to satisfy the "so closely related" standard when a proposed activity has not generally been performed by banks, the activity must facilitate other banking operations.

Schwab's principal business, the determinative activity here, is execution of securities trades for the public, an activity banks generally have not performed and which does not further banking operations. The Board sanctioned the activity under Section 4(c)(8) *solely* upon a finding that it was "functionally similar" to other banking activities so that banks are equipped to perform it, *regardless* of whether the activity facilitates banking operations. In so doing, the Board administratively amended the statute to include a "functionally simi-

14 *See* 48 Fed. Reg. 37003 (Aug. 16, 1983).

lar" standard it had previously urged upon Congress, but which Congress rejected.

By embracing the Board's rationale, the decision below not only conflicts with that of another Court of Appeals, but it transforms Section 4(c)(8) into an open-ended authorization. Under it banking organizations may be permitted to engage in any number of businesses otherwise completely unrelated to banking merely because they are seen as "functionally similar" to what some banks may do.

II. The Glass-Steagall Act, reflecting Congressional reaction to the crash of 1929 and the subsequent near-total failure of the banking system, sought to separate banking from the securities business by prohibiting bank securities activities, with only very specific exceptions. The four sections of the Act, as parts of a comprehensive statutory structure, should be construed consistently. Aimed at the same group of prohibited activities, the four sections are designed to bar banks *entirely* from engaging in those activities themselves and from affiliating with any entity that is engaged *principally* in them. The only difference in these restrictions thus concerns the level, not the type, of activities permitted for bank affiliates as opposed to banks.

The "public sale" of securities, as used in Section 20 of the Glass-Steagall Act, encompasses the same activities as its functional equivalent, "purchasing and selling," used in Section 16 of the Act. Section 16 prohibits banks from engaging in public securities brokerage, permitting only accommodation services for bank customers, if undertaken "without recourse" (*i.e.*, without risk of liability to third party purchasers or sellers). Congress understood the Glass-Steagall Act limited banks to forwarding orders from their banking customers to brokers for execution. It was on that premise that (a) the Comptroller of the Currency convinced Congress in 1935 to permit banks to accommodate orders for stock and (b) the proponents of the Securities Exchange Act of 1934 convinced Congress to except banks from the otherwise broad definition of "broker" in that Act. Because Schwab's principal activity is

securities execution for the public with full liability to third party purchasers and sellers, the Glass-Steagall Act prohibits a bank's affiliation with Schwab.

III. Deference to the Board's ruling, transforming narrow statutory exceptions into broad authorizations, is particularly inappropriate, in that only legal issues are here involved. The Board has no rulemaking authority under the Glass-Steagall Act and, whatever latitude it may have under the "so closely related" provision of the Bank Holding Company Act, it does not have discretion to rewrite the statute.

ARGUMENT

This case, important alone, raises broader policy issues of enormous economic import. Based on a century of experience, Congress has built a carefully balanced statutory structure to govern the financial services industry in this country. Extreme caution is warranted before it is in any way rearranged, even by Congress, lest the entire scheme become unbalanced.[15] During several recent terms Congress has been considering whether and, if so, how the governing structure can or should be reshaped. Thus far, Congress has reaffirmed repeatedly the fundamental public policy of separating banking from commerce.

From the time Congress chartered the Bank of the United States in 1816, two basic propositions have controlled the structure of federal bank regulation. First, banks are institutions of limited, statutorily defined power; they possess no authority beyond that expressly granted by law.[16] Second, as a

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15 *See, infra*, pp. 44-46.

16 *E.g.*, *California Bank* v. *Kennedy*, 167 U.S. 362, 366 (1897); *Texas & Pacific Ry.* v. *Pottorff*, 291 U.S. 245, 253 (1934); *Investment Co. Institute* v. *Camp*, 274 F. Supp. 624, 638 (D.D.C. 1967), *rev'd sub nom.*, *Comptroller of Currency* v. *Investment Co. Institute*, 420 F.2d 83 (D.C. Cir. 1969), *rev'd sub nom.*, *Investment Co. Institute* v. *Camp*, 401 U.S. 617 (1971).

matter of national banking policy, banks generally are to be isolated from other lines of commerce, particularly the securities business.[17]

Both statutes involved in this case reinforced these principles. The Congressional restrictions, brushed aside by the Board in this case, are clear from the statutory language. For the last half century, bank affiliates have avoided public securities brokerage. Such abstinence is itself one of the surest guides to the meaning of any statutory restrictions. Even if the statutory limitations were ambiguous, however, consideration of any substantial change in the established structure of the financial services industry should be addressed only as part of Congress' ongoing inquiry. It should not be preempted, as here, by *ad hoc* administrative reaction to industry pressures.

I.

THE DECISION BELOW IS CONTRARY TO THE BANK HOLDING COMPANY ACT

The Bank Holding Company Act generally sought to prohibit bank affiliates from conducting activities other than banking. The court below, however, construed a narrowly drawn exception to that prohibition as authorizing bank affiliates to enter any line of commerce that banks have the operational or functional capacity to perform. Not only does this result conflict with a decision of another Circuit Court of Appeals; it defeats the basic Congressional policy underlying the Bank Holding Company Act.

That Act closed a statutory loophole through which banks, by using holding companies, were able to engage in activities otherwise prohibited to them. As explained by the Chairman of the House Committee on Banking and Currency, the legisla-

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17 *See, e.g., Fleckner* v. *Bank of the United States*, 21 U.S. 338, 351 (1823); *Awotin* v. *Atlas Exchange Bank*, 295 U.S. 209, 214 (1935). *See also* Note, *National Banks and the Brokerage Business: The Comptroller's New Reading of The Glass-Steagall Act*, 69 Va. L. Rev. 1303 (1983).

tion was designed to "divorce from holding companies" the power "to engage in unrelated business" that had always been denied to banks. 101 Cong. Rec. 8020 (1955) (remarks of Rep. Spence).[18]

Congress allowed only a few narrow exceptions to this general restriction, permitting bank affiliates to provide certain bank support activities, such as owning the physical property occupied by a bank and operating a safe deposit business. *See, e.g.*, 12 U.S.C. § 1843(c)(1). The exception involved in this case, while less specific, was similarly understood to have a narrow focus. As enacted in 1956, it authorized bank affiliates to conduct only activities determined by the Board to be "so closely related to the business of banking . . . as to be a proper incident thereto." Pub. L. No. 511, § 4(c)(6), 70 Stat. 137 (1956). Senator Robertson, Chairman of the Senate Committee on Banking and Currency, and a sponsor of the original Act, explained that the purpose of the exception was to allow "holding companies to continue to carry on functions closely related to banking which are *essential* for their efficient operation." 102 Cong. Rec. 6755 (1956) (emphasis added).[19]

Congress thus required a close connection between any bank holding company activity and the business of banking. As William McChesney Martin, then the Board's Chairman, testified during hearings in 1969 on proposed amendments to the

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18 A member of the Senate Banking and Commerce Committee explained during debate on the controversial bill:

> [T]he purpose of the bill . . . is to make certain that a bank holding company cannot lawfully do something that a bank cannot do.
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> * * *
>
> [M]any, many years ago Congress adopted the philosophy that banks ought not to engage in outside business. . . . [W]hat we are trying to do is bring bank holding companies within the same rules and regulations that apply to ordinary banks.

102 Cong. Rec. 6933, 6936 (1956) (remarks of Sen. Capehart).

19 *See also* H.R. Rep. No. 609, 84th Cong., 1st Sess. 16–17 (1955) ("Your committee has, however, exempted certain specific businesses which it believes to be obviously incidental to the business of banking."); S. Rep. No. 1095, 84th Cong., 1st Sess. 2 (1955).

Act, the "so closely related" exception required "a direct and significant connection between the proposed activities of the company acquired and the business of banking."[20]

The Board urged Congress in 1969 to eliminate the "so closely related" test and to substitute a more flexible standard of "functionally related" to banking (*id.*), but Congress refused to do so. Although both Houses of Congress included a "functionally related" test in bills passed to amend the Bank Holding Company Act, the modification was deleted in Conference Committee.[21] As re-enacted in 1970, the exception of Section 4(c)(8) required that proposed activities be "so closely related to banking . . . as to be a proper incident thereto." 12 U.S.C. § 1843(c)(8).[22]

Although the Board has some latitude under Section 4(c)(8) to determine what activities comport with the "so closely related" standard, the Board does not have discretion to rewrite the standard.[23] Yet, that is what has occurred. Despite the statutory language and its legislative history, the Board here

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20 *See Hearings on H.R. 6778 Before the House Committee on Banking and Currency*, 91st Cong., 1st Sess. 199 (1969).

21 *Compare* S. Rep. No. 1084, 91st Cong., 2d Sess. 25 (1970) and H.R. Rep. 387, 91st Cong., 1st Sess. 1 (1969) *with* H.R. Conf. Rep. 1747, 91st Cong., 2d Sess. 5 (1970), *reprinted in* 1970 U.S. Code Cong. & Ad. News 5561, 5564.

22 The only change Congress made in 1970 was to delete the words, "the business of", from the statutory phrase "so closely related to [the business of] banking." This change made it permissible for a holding company affiliate to engage in activities closely related to those of banks in general, even if the specific holding company involved was not so engaged. *Board of Governors* v. *Investment Co. Institute*, 450 U.S. 46, 73 n.51 (1981). *See also* H.R. Conf. Rep. No. 1747, 91st Cong., 2d Sess., *reprinted in* 1970 U.S. Code Cong. & Ad. News 5561, 5572; 116 Cong. Rec. 41956 (1970) (remarks of Rep. Widnall).

23 *See*, *United States* v. *Larionoff*, 431 U.S. 864, 873 & n.12 (1977) ("a rule out of harmony with the statute, is a mere nullity"); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 213-14 (1975) ("rulemaking power . . . is not the power to make law").

did not require that the proposed brokerage activity have a "direct and significant connection" with banking, or indeed any connection with banking at all.

Nor is this even an instance where approval was sought to engage in a new, nonbanking activity to facilitate or support other banking operations, such as bank trust departments. Rather, the activity approved here is to be aggressively marketed to the public in general as an *independent*, nonbank undertaking.

The determinative activity in this case is executing securities transactions for the public, the principal business of Schwab.[24] Both the Board (129A) and the court below (171A-172A) recognized that this business is not something that previously has been undertaken by banks.[25] The acquisition was pursued because, through it, BAC sought "to enter the market for brokerage services."[26]

The Board therefore could not authorize the Schwab acquisition on the basis that banks have generally conducted securities execution; instead, it did so based on its view that Schwab's activities are "operationally or functionally very similar" to an activity generally conducted by banks. (129A.) For that reason alone, the Board believed the activity may be considered "so closely related to banking . . . as to be a proper incident thereto."

The functional *similarity* found sufficient by the Board is a far cry from the operational *connection* required by Congress. By administrative fiat the Board in effect has substituted its

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24 From 1980 to 1982 Schwab executed an average of 2,000 to 3,000 trades per day, the vast majority of which were executed on the New York and American Stock Exchanges. Testimony of Lawrence J. Stupski, President of Schwab, at 66-74 (September 8, 1982).

25 *See* Department of the Treasury, *Public Policy Aspects of Bank Securities Activities: An Issues Paper* at 5 (Nov. 1975) ("[a]t the present time, commercial banks do not execute securities transactions directly for their customers").

26 Application to the Board of Governors of the Federal Reserve System by BankAmerica Corporation at 3 (Feb. 8, 1982).

proposed "functionally related" criterion for the statutorily required "so closely related" test, precisely the substitution Congress itself refused to make in 1970.[27]

The Board's action went substantially beyond this Court's ruling in *Board of Governors* v. *Investment Co. Institute*, 450 U.S. 46 (1981) ("*ICI* II"), incorrectly cited in support of the Board's position by the court below. (173A-174A.) Unlike the present situation, the activity authorized for a bank affiliate in that case, providing investment advice, was not merely similar to banking activities, it *was* a banking activity—one that "for over 50 years banks have performed." *Id.*, 450 U.S. at 55. Nor did this Court adopt the rationale there that the Board followed here. To the contrary, this Court instructed the Board, upon subsequent applications, to "*ensure that no bank holding company exceeds the bounds of a bank's traditional fiduciary function*." *Id.*, 450 U.S. at 57 (emphasis added). Yet the Board here has approved an activity that plainly does exceed "the bounds of a bank's traditional [securities] function."

The decision below also conflicts with judicial authority that did reach the issue here involved. In *Alabama Association of Insurance Agents* v. *Board of Governors*, 533 F.2d 224 (5th Cir. 1976), *cert. denied*, 435 U.S. 904 (1978), the Fifth Circuit addressed a Board regulation permitting subsidiaries of bank holding companies to engage in a variety of insurance brokerage activities that banks themselves had not previously performed. The court approved only those activities having a demonstrated connection to the basic functions of banks. 533 F.2d at 240-41. Conversely, the court rejected aspects of the Board regulation that permitted a bank holding company subsidiary, *inter alia*, to act as an insurance broker on behalf of the holding company or any nonbank subsidiaries. The court did so because brokering "[s]uch insurance simply does not

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27 *See Pacific Gas & Electric Co.* v. *State Energy Resources Conservation & Development Commission*, ___ U.S. ___, 103 S. Ct. 1713, 1730 (1983) (improper to give a reading to an Act that Congress considered and rejected).

contribute to the operations of those subsidiaries actually engaged in the banking business" (*id.*, 533 F.2d at 241)—even though such brokering was *functionally similar* to that done directly in support of bank activities, which was held to be permissible.[28] It was just such a functional similarity, however, that the court below found to be sufficient.

In accepting the Board's reading of the Bank Holding Company Act, the Second Circuit cited *National Courier Association* v. *Board of Governors*, 516 F.2d 1229 (D.C. Cir. 1975). The court in that case described three factors it believed could be relevant in applying the standard of Section 4(c)(8), the second of which the Board purported to apply here.[29] But,

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28 Similarly, the court refused to allow holding company affiliates to perform the functionally similar activity of selling insurance as a "matter of convenience" for the purchaser, explaining (533 F.2d at 242):

> The Board's function is not to promote generally the public interest consistent with the policies of the Bank Holding Company Act, but to determine what activities are "closely related" to banking. While we might agree that the sale of certain types of convenience insurance would help a holding company agency "round out" its offerings to the benefit of its clients, the agency and the general public, the fact remains that the handling of convenience insurance simply is not, as broadly defined in the regulation, closely related or necessarily related at all to banking.

29 The three indicia, as described by the *National Courier* court (516 F.2d at 1237), were:

> 1. Banks generally have in fact provided the proposed services.
>
> 2. Banks generally provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed service.
>
> 3. Banks generally provide services that are so integrally related to the proposed services as to require their provision in a specialized form.

If banks generally had executed securities trades, the proposed acquisition would have satisfied the first factor, and the Board would not have reached the second. However, the Board properly found that the first criterion had *not* been satisfied, noting, in a masterpiece of understatement, that "Schwab's activities differ somewhat from the brokerage functions usually performed by banks." (129A.) As the Board found, unlike banks, "Schwab executes orders for the purchase or sale of securities directly, without the

properly applied, this factor does not permit what the holding of the court below would allow.

The factors listed by the court in *National Courier* are merely aids to construing the "so closely related" standard in a manner that is "consistent with the legislative intent." *Id.*, 516 F.2d at 1237. As discussed, the legislative history of Section 4(c)(8) shows that its requirement is *not* met merely by showing that an activity looks like, or is "functionally similar" to, an activity of banks; rather, a nonbanking activity must be in furtherance of a permissible banking function before it may be considered "so closely related to banking . . . as to be a proper incident thereto." Thus, the court there found that courier activities involving materials other than financial data, and offered to the general public rather than to banks, were not even properly an "incidental" activity for a bank affiliate, much less "closely related" to banking. *Id.*, 516 F.2d at 1240-41. The activities were proscribed even though acting as a courier of non-financial data was *functionally identical* to acting as a financial data courier.

The Second Circuit, alone, has by the decision below sanctioned a nonbanking activity under Section 4(c)(8) *solely* upon a finding that banks are equipped to perform it, and *regardless* of whether the activity facilitates banking operations.

The consequences of this decision extend substantially beyond the confines of this case. Under the Board's "functionally similar" rationale, embraced by the court below, the capacity of banks to execute "wire transfers" of funds could, for example, be argued as sufficient to allow bank affiliates to enter the public telecommunications industry.[30] Even the long

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assistance of an intervening broker; and executes directly on the exchange orders involving securities listed on such exchanges." (*Id.*)

The court below also observed "one principal difference between the securities activities of brokerage houses and of banks: brokerage houses trade listed securities, directly on the exchanges, while banks historically have used intervening brokers." (171A-172A.)

30 Indeed, the American Bankers Association, responding recently to a Board proposal to expand its pre-approved list of nonbanking activities,

history of bank incentive programs, providing customers with toasters, calculators and other consumer goods, could be claimed as enough to justify entry into the "functionally similar" activity of retail consumer sales.[31]

Absent action by this Court, the statutory language of the Bank Holding Company Act will remain turned inside out. A narrowly drawn exception to a broad Congressional prohibition will be transformed administratively into an unintended and open-ended authorization.[32] For this reason alone, the decision below should be reversed.

II.

THE DECISION BELOW IS CONTRARY TO THE GLASS-STEAGALL ACT

The Glass-Steagall Act was passed in the wake of the near-total collapse of the American financial system—a collapse blamed in large part on abuses by national banks in the securities area. By the end of the 1920s, national banks had expanded their activities to the point of dominating investment banking, and "the institutional separation" of commercial and investment banking had become largely "a thing of the

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requested the Board to permit a variety of telecommunications services under Section 4(c)(8). *See* 41 Wash. Fin. Rep. (BNA) No. 7 at 225 (Aug. 15, 1983).

31 The court below also thought it significant that a few large banks currently may "direct" brokers on the method of execution they want used. (172A.) But, it could equally be said that some banks "direct" insurance and real estate brokers in procedures to be followed. Under the rationale of the Court of Appeals, bank affiliates could therefore also be said to be qualified to open retail operations in those areas—directly contrary to Congress' fundamental determination to *separate* banking from commerce in general.

32 It would be particularly anomalous if public securities brokerage, which is entirely prohibited for banks under the Glass-Steagall Act (*see, infra*, pp. 20-34), could nevertheless be deemed a "proper incident" to "banking" under Section 4(c)(8) when it is the principal business of a bank holding company affiliate.

past."[33] By February 1933 the question in the public mind was not whether, but when, the system would collapse totally,[34] and the five-day national banking holiday declared by the President on March 5, 1933 signalled that collapse.

Congress' legislative response was the Glass-Steagall Act. Passed in 1933 and initially amended in 1935, the Act remains a firm prohibition on the securities activities of national banks. In stark contrast to other legislation passed during that era,[35] the terms of the Glass-Steagall Act are not regulatory but prohibitory. Congress did not seek to supervise bank securities activities; it sought to prohibit them, with only narrowly circumscribed exceptions.

The Glass-Steagall Act was "a prophylactic measure directed against conditions that the experience of the 1920's showed to be great potentials for abuse," not only by national banks, but by all depository institutions. *Investment Co. Institute* v. *Camp*, 401 U.S. 617, 629 (1971) ("*ICI* I"). Through the Glass-Steagall Act, Congress meant to separate depository institutions from the securities business "as completely as possible." *ICI* II, 450 U.S. at 70.

A. The Glass-Steagall Act Limits Bank Securities Activities Solely To Riskless Accommodation Services Provided To Bank Customers

One of Congress' specific concerns in adopting the Glass-Steagall Act was the combination of securities brokerage and commercial banking. Representative Kopplemann, a member

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33 Perkins, *The Divorce of Commercial and Investment Banking: A History*, 88 Banking L.J. 483, 496 (1971).

34 During the winter of 1932-33, thirty states declared complete or partial bank holidays, and almost 2,300 bank failures occurred across the country. Willis and Chapman, *The Banking Situation* at 7, 10 (1934); Klebaner, *Commercial Banking in the United States: A History* at 131-35 (1974).

35 *E.g.*, Securities Act of 1933, 15 U.S.C. §§ 77a, *et seq.*; Securities Exchange Act of 1934, 15 U.S.C. §§ 78a, *et seq.*

of the House Banking and Currency Committee, urged during the debates on the Act that "[t]he unholy alliance between the brokerage office and the banks must be broken." 77 Cong. Rec. 3907 (1933). He explained that a bank director should be precluded from acting as a fiduciary for depositors at the same time as "he wants to add to the commissions and underwriting profits of his own company." *Id.* Again, describing before the House the section of an initial bill that ultimately became Section 21 of the Glass-Steagall Act, Representative Luce, a co-manager of the bill along with Representative Steagall, explained that the Section "cuts out brokers from deposit banking." 77 Cong. Rec. 3916 (1933). In short, as this Court has observed, Congress intended the Glass-Steagall Act to separate depository institutions from "securities firms such as underwriters or brokerage houses." *ICI* II, 450 U.S. at 63.

Congress addressed the brokerage question most specifically in Section 16 of the Act. There, it revoked the authority to deal in investment securities it had recognized for the first time only several years earlier[36] and, as amended in 1935, provided that henceforth that business would be "limited" strictly to "purchasing and selling securities and stock without recourse, solely upon the order, and for the account of, customers and in no case for its own account." *See* 49 Stat. 684 (1935). Through Section 16, as will appear, Congress meant to restrict banks solely to accommodating their banking customers by forwarding the customers' securities orders to brokers for execution.

1. Banks are limited to accommodating orders from their banking customers.

Banks are limited by the statutory language solely to accommodating orders of their "customers". That Congress meant to limit this service solely to *banking* customers appears from

36 In 1927, in response to competitive pressure from state banks and trust companies, Congress for the first time granted national banks authority to deal in "investment securities" (high quality debt instruments, but not corporate stock). McFadden Act, c.191, § 2, 44 Stat. 1226 (1927).

the statutory language itself, particularly when compared with the language of statutes that deal with public securities brokerage. In the Glass-Steagall Act, avoiding broader terms such as "third parties" or "others", Congress limited the activity to "customers"; whereas, in contemporaneously enacted securities statutes Congress used the unrestricted phrase, "for the account of others."[37]

Even assuming there were ambiguity in the limitation intended by the Glass-Steagall Act, its legislative history and decades of consistent administrative construction leave no doubt as to its scope. The relevant language of the statute derives from Congressional action in 1935. The applicable history begins in January 1934 with concern expressed by the Comptroller of the Currency, who had authority over all national banks, that Congress in 1933 had gone too far in Section 16, by limiting the accommodation services allowed to "investment securities."[38]

In his first Annual Report to Congress (required by 12 U.S.C. § 14) after the Act's passage, the Comptroller noted that "[i]t would appear from the language [of Section 16] that a national bank is prohibited from performing the service of purchasing or selling corporate stocks for the account of one of its customers." However, the Comptroller stated his belief "it was not the intention of Congress to penalize the public located in communities removed from the money centers in disposing of or purchasing securities in the form of corporate

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37 *See* Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(4), enacted by the same Congress the following year. That statute of course related to the public brokerage business. In it Congress defined a "broker" broadly as a person "engaged in the business of effecting transactions in securities for the account of others. . . ." Ch. 404, § 3(a)(4), 48 Stat. 881, 883 (1934). *See* Note, *National Banks and the Brokerage Business: The Comptroller's New Reading of the Glass-Steagall Act*, 69 Va. L. Rev. 1303, 1325-30 (1983).

38 As initially enacted, Section 16 provided: "The business of dealing in investment securities by the association shall be limited to purchasing and selling such securities without recourse, solely upon the order, and upon the account, of customers. . . ." Glass-Steagall Act, c.89, § 16, 48 Stat. 184.

stocks for investment purposes." *Annual Report of the Comptroller of the Currency* at 11 (Jan. 3, 1934).[39] He recommended that the section be amended also to include stock, emphasizing that "this does not entail the investment by the bank of its own funds *and the bank merely acts in an accommodation capacity.*" (*Id.*, emphasis supplied.)

The House and the Senate banking committees both accepted the Comptroller's recommendation in bills reported out to the full Congress,[40] but the proposed legislation foundered on the last day of the legislative session.[41]

In a letter sent to all national bank examiners a month later, the Comptroller stated that "my contact with Congress convinces me that my statement with reference to the intention of that distinguished body was correct and that only the rush of closing business prevented the passage of the bill." He then announced: "I have this day held that national banks have the right to purchase and sell stocks solely upon the order and for the account of customers," but again emphasized that "*this*

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39 The Committee Reports accompanying the Glass-Steagall Act had said that "[n]ational banks are to be permitted to purchase and sell investment securities for their customers to the same extent as heretofore. . . ." S. Rep. No. 77, 73d Cong., 1st Sess. 16 (1933). *See also* H.R. Rep. No. 150, 73d Cong., 1st Sess. 16 (1933). Banks had previously accommodated orders for securities and stock from their customers as an incident to their banking services. *See, e.g.*, *Block* v. *Pennsylvania Exchange Bank*, 253 N.Y. 227, 232, 170 N.E. 900, 901 (1930) (referring to the general practice of "the purchase of securities for the benefit of customers whose loan deposit accounts are sufficient, as a result of loans or otherwise. . . .").

40 For example, Section 4(a) of S. 3748, 73d Cong., 2d Sess. 3-4 (1934) would have amended Section 16 to read: "The business of dealing in investment securities and stock by the association shall be limited to. . . ." *See* S. Rep. No. 1260, 73d Cong., 2d Sess. 2-3 (1934) ("This amendment was recommended by the Comptroller of the Currency in his Annual Report dated Jan. 3, 1934.").

41 *See Hearings on H.R. 5357 before the House Committee on Banking and Currency*, 74th Cong., 1st Sess. 661 (1935).

does not mean that national banks may do a brokerage business."[42] (*Id.*, emphasis supplied.)

The Federal Reserve Board, in turn, similarly concluded in September 1934 that state-member banks under its jurisdiction could accommodate their customers by forwarding orders to buy and sell stock, but quoted the Comptroller's statement that "[t]his does not mean that national banks may do a brokerage business." 20 Fed. Res. Bull. 609 (1934).[43]

The Comptroller continued to press his amendment after Congress convened in 1935. Echoing what he had said in his January 1934 Annual Report and his July 1934 ruling, the Comptroller told the House Banking Committee his amendment would make clear that:

> section 16 of the Banking Act of 1933 was not intended to prohibit national banks or member banks from buying or selling stocks *solely for the account of their customers and as an accommodation thereto* and not for their own account.[44]

It was no accident that throughout 1934-35 the Comptroller repeatedly pointed out the "accommodation" restriction on bank activities imposed by Section 16. He was urging Congress to amend Section 16, which in part sought to prohibit speculation in securities, in order to permit banks expressly to transmit orders for stock, often a highly speculative security. Even in the

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42 This ruling was reprinted in *American Banker*, July 10, 1934 at 3. The Comptroller's ruling became necessary because the restrictions in Section 16 on dealing in securities had become effective in June 1934. *See* 48 Stat. 185 (1933).

43 Under 12 U.S.C. § 335 state member banks were, and are, subject to the same limitations upon transactions in stock as national banks.

44 *Hearings on H.R. 5357 before the House Committee on Banking and Currency*, 74th Cong., 1st Sess. 663 (1935) (emphasis added). The Comptroller made much the same statement before the Senate Banking Committee. *Hearings on H.R. 7617 before the Senate Committee on Banking and Currency*, 74th Cong., 1st Sess. 154-55 (1935).

McFadden Act of 1927, the *only* instance in which Congress expressly authorized banks to deal in securities, Congress had limited the authority to the substantially less risky "investment securities." *See* 44 Stat. 1226 (1927). Obviously aware that Congress would be sensitive to his proposal, the Comptroller was careful to emphasize the limited role permitted for banks under the Glass-Steagall Act.

Based upon the Comptroller's testimony that banks were already prohibited from a general brokerage business, uncontradicted by any other legislative history, Congress amended the Glass-Steagall Act in 1935 to include "securities and stock" within Section 16 rather than only "investment securities." Banking Act of 1935, c.614, § 303, 49 Stat. 707.

The Congressional understanding of the limitation contained in Section 16 is also confirmed by the legislative history of the Securities Exchange Act of 1934, which was being debated at the same time Congress was considering the Comptroller's original proposal to amend the Glass-Steagall Act.[45] An important witness during the February 1934 hearings on that securities legislation was Thomas G. Corcoran, one of its principal draftsmen. Mr. Corcoran voiced concern during his testimony that banks, which had been removed from the public securities brokerage business by the Glass-Steagall Act, might inadvertently be covered by proposed regulations intended only for securities brokers. Addressing a provision imposing borrowing limitations on "any person who transacts a business in securities," including those who forward orders to brokers for execution, he explained:

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45 It was generally recognized that the Glass-Steagall Act and the Securities Exchange Act were parts of a comprehensive legislative scheme. As Marriner S. Eccles, Governor of the Federal Reserve Board, testified: "[a]nother purpose of recent banking legislation, and particularly of the banking bill of 1933 and of the portions of the Securities Exchange Act that deal with the powers of the Federal Reserve Board, has been to prevent the recurrence of speculative excesses which preceded the recent break-down of our banking machinery and were partly responsible for this collapse." *Hearings on H.R. 5357 before the House Committee on Banking and Currency*, 74th Cong., 1st Sess. 179-80 (1935).

The bill needs to be clarified, so that a bank which just acts for you in passing on an order to a broker, for you, does not come within that sort of a provision.

MR. KENNEY. Why should that limitation be taken out?

MR. CORCORAN. Because there are plenty of other limitations on the banks. A bank cannot normally go in the business, like a broker, of dealing in securities. For your convenience, for a service—

MR. KENNEY. But they do.

MR. CORCORAN. They are not allowed to do those things any longer, under the Glass-Steagall bill. They cannot go into a business of dealing in securities, but they can still make a service charge for passing on for you, as a customer—[46]

Again, testifying before the Senate Banking Committee, Mr. Corcoran explained that the provision should exclude banks because:

> Of course under the Glass-Steagall bill a bank can no longer peddle securities at retail. It can do two things: it can buy securities for its own account, for its own investment; and it can act as agent to transmit to a broker an order to purchase or sell securities, given to it by one of the bank's customers.
>
> Certainly we had no conception when we drafted the language of this bill that it would be said that if a bank bought securities for its bond account, or merely transmitted, for a service charge, an order from a customer to a broker (because very often customers of banks do not know whom to go to for brokerage service), that operations of that kind on the part of a bank constituted transacting a business in securities.
>
> And I might say that if there is any difficulty with that language, or any conception that it does cover a bank,

46 *Hearings on H.R. 7852 and 8720 before the House Committee on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 86 (1934).

> acting as banks may act under the Glass-Steagall Act, then the language should be changed so that banks so acting are not within the scope of the language. . . .[47]

The Senate Banking Committee before whom Corcoran testified was the same committee that, in the first session of the same Congress, had considered the bill that became the Glass-Steagall Act, and the same committee that in 1934 would accept the Comptroller's proposed amendment to that Act. Plainly, if any of its members had disagreed with Mr. Corcoran's summary of the Glass-Steagall restrictions, the hearings would reflect it. They do not. Instead, accepting the Corcoran recommendation, Congress expressly excepted banks from the definition of a "broker" in the Securities Exchange Act, 15 U.S.C. § 78c(a)(4), obviously understanding that banks, as Mr. Corcoran had explained, were not permitted to engage in the securities brokerage business.[48]

In sum, Congress *twice* enacted legislation freeing banks from limitations that otherwise would have applied, after hearing explanations by the proponents of the legislation that banks were severely limited by the Glass-Steagall Act to accommodating their banking customers by forwarding securities orders to brokers for execution. And, as this Court put it in *Zuber* v. *Allen*, 396 U.S. 168, 192 (1969):

> [W]hen the administrators participated in drafting [enabling legislation] and directly made known their views to Congress in committee hearings . . . absent any indica-

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47 *Hearings on S. Res. 84, 56 and 97 before the Senate Committee on Banking and Currency*, 73d Cong., 1st Sess. 6470 (1933).

48 Congress' solution to Corcoran's concern about the specific borrowing limitation addressed was, first, to make it applicable only to members of national securities exchanges and to "brokers" and "dealers" who transact business with them; and, second, to exclude banks from the Act's definition of "broker" and "dealer". *Compare* S. 2693, 73d Cong., 2d Sess. §§ 3.4, 3.5 and 7 (Feb. 1934) with S. 3420, 73d Cong., 2d Sess. §§ 3(a)(4), 3(a)(5) and 7(a) (April 1934).

> tion that Congress differed with the responsible department, a court should resolve any ambiguity in favor of the administrative construction, if such construction enhances the general purposes and policies underlying the legislation.

Here: (1) the Comptroller proposed the statutory amendments to the Glass-Steagall Act; (2) the Comptroller made known his views concerning the accommodation limitation in statements before Congressional committees; (3) Congress subsequently enacted the proposed amendments with no indication of a contrary intent; and (4) the Comptroller's construction furthered a statutory purpose of separating banks from transactions in speculative securities. The same applies to the Corcoran testimony concerning the Securities Exchange Act.[49]

The Comptroller's office reaffirmed the limited scope of the brokerage exception in interpretations issued immediately after the 1935 amendments to the Glass-Steagall Act had been passed, and repeatedly thereafter for almost fifty years. The Comptroller's 1936 Digest of Opinions, for example, stated that Section 16:

> is to be construed as limiting the purchase and sale transactions mentioned *to actual customers of the bank, which customer relationship exists independently and apart from the particular transaction in which the bank buys or sells* upon the order and for the account of such "customer," in distinction to the relationship arising solely by virtue of the particular transaction. . . .[50]

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49 Corcoran was one of a small group assembled to draft the bill after Senator Fletcher, Chairman of the Senate Banking Committee, requested Commissioner J.M. Landis of the Federal Trade Commission to prepare legislation to regulate the stock exchanges. *See Hearings on H.R. 7852 and 8720 before the House Committee on Interstate Banking and Commerce*, 73d Cong., 2d Sess. 82-83 (1934).

50 1 *Bulletin of the Comptroller of the Currency* No. 2 at 2 (Oct. 26, 1936) (emphasis added).

The Comptroller's Digests published over the ensuing *three decades* were equally firm.[51] Although the Comptroller's Digests were discontinued in the early 1960s, the Comptroller's view of the limited accommodation brokerage exception stood until 1982.[52] In August of that year, six months *after* BAC filed its application to acquire Schwab, the Comptroller repudiated his earlier interpretations of Section 16 in approving an application by Security Pacific National Bank to establish an operating subsidiary to engage in public securities brokerage.[53]

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51 Comptroller's Digests were published in 1948, 1957 and 1960. The Comptroller's 1957 Digest, for example, stated:

> Services in this field must be limited to actual customers of the bank—*that is, the customer relationship must exist independently of the particular securities transaction.*

Digest of Opinions of the Comptroller of the Currency, § 220A (1957) (emphasis added). Again, in 1960 the Comptroller held:

> Although R.S. 5136 [in pertinent part, § 16 of the Glass-Steagall Act] prohibits national banks from dealing in securities (except so-called "exempt" securities) for their own account, it permits them to purchase and sell securities (including stock) for the account of their customers. *However, the activities of the bank in this capacity are confined to those of an accommodation agent for the convenience of customers.*

Digest of Opinions of the Comptroller of the Currency, § 220, 220A (1960) (emphasis added).

52 In 1974, addressing the operation of "automatic investment service" plans by national banks, the Comptroller said he regarded his earlier opinions perhaps to have been over-cautious to the extent they prohibited a bank from charging a fee for this service. He retained all other aspects of his earlier opinion, however, including the requirement that customers for whom brokerage services were performed must have a *bona fide* banking relationship with the bank. *See* letter to G. Duane Vieth (June 10, 1974), *reprinted in* [1973-78 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 96,272.

53 Since that decision Security Pacific has incorporated a wholly-owned brokerage subsidiary and has bought its own seat on the New York Stock Exchange. *See* N.Y. Times, Aug. 3, 1983 at D6, col. 1; 39 Wash. Fin. Rep. (BNA) No. 9 at 378 (Aug. 30, 1982). The Comptroller's decision is now the subject of a court challenge. *See, infra,* n. 54.

The court below was inclined to give "significant weight" to the Comptroller's reversal. (167A.) But, coming as it did after five decades of directly contrary interpretation, through the administrations of no fewer than seven different Comptrollers, the recent ruling actually is entitled to virtually no weight. *Watt* v. *Alaska*, 451 U.S. 259, 273 (1981). The prior, long-standing administrative construction by "[t]hose who knew best what Congress intended" is entitled to substantial weight over recently articulated administrative revisions. *Morton* v. *Ruiz*, 415 U.S. 199, 237 (1974); *Espinoza* v. *Farah Manufacturing Co.*, 414 U.S. 86, 94 (1973).[54]

The Comptroller's statutory construction of several decades was also consistent with the general limitation upon the "incidental" powers of banks.[55] A line is to be drawn between (a) services offered to bank customers as an incident to their banking relationship and (b) services offered to the public at large, which are plainly *ultra vires* for banks. In *Arnold Tours, Inc.* v. *Camp*, 472 F.2d 427 (1st Cir. 1972), for example, the Comptroller argued that banks could conduct a public travel agency because they had obtained tickets for their regular customers in the past. But, as the First Circuit held in rejecting the argument, an "incidental good will service of this kind cannot reasonably be equated with the operation of a modern travel agency for profit." 472 F.2d at 433.

It would be anomalous indeed if the law condoned an administrative agency's first convincing Congress to amend a

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54 Judge Flannery of the District Court for the District of Columbia, relying upon his own decision in *New York Stock Exchange* v. *Smith*, 404 F. Supp. 1091 (D.D.C. 1975), *vacated sub nom. New York Stock Exchange* v. *Bloom*, 562 F.2d 736 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 942 (1978), has affirmed the Comptroller's new construction of the Glass-Steagall Act, in a decision now on appeal. *Securities Industry Ass'n* v. *Conover*, No. 82-2865 (D.D.C., Dec. 16, 1983), *appeal docketed*, No. 84-5085 (D.C. Cir. Feb. 9, 1984).

55 Section 16 in fact was an amendment to the section of the National Bank Act of 1864, 13 Stat. 101, that confers "incidental" powers upon national banks. 12 U.S.C. § 24 (Seventh).

prohibitory statute to include expanded authority on the ground that the affected institutions were already subject to other strict limitations on how the requested authority could be used, and then, after that expanded authority is obtained, doing an administrative about-face to announce—with no further Congressional action—that the other limitations never existed at all.

2. Banks are limited to forwarding orders on a "without recourse" basis.

Congress' understanding that banks were prohibited from engaging directly in the brokerage business is also reflected in its requirement that bank securities services be "without recourse." Although in its narrowest sense that phrase means without endorsement or guaranty, this Court has specifically admonished that it is *not* to be so limited; rather, the words were "used in a broad and nontechnical sense." *Awotin* v. *Atlas Exchange National Bank*, 295 U.S. 209, 212 (1935). As was held in *Awotin*:

> The phrase is broader than a mere limitation upon the power to contract, although embracing that limitation. It is a prohibition of liability, whatever its form, by way of "recourse" growing out of the transaction of the business.

Id., 295 U.S. at 214.

The *Awotin* decision addressed "without recourse" as used in a section of the McFadden Act that previously had permitted principal activities in securities.[56] Congress left the "without recourse" limitation in place when it amended that section in 1933 through the Glass-Steagall Act to restrict banks solely to accommodation services and, again in 1935, when Congress amended the section to include stocks.

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56 *Awotin* concerned a claim by a purchaser of bonds from the defendant bank which, as a principal, had agreed to repurchase the bonds at the price the purchaser had paid for them plus accrued interest. This Court found the bank's assumption of liability prohibited by the "without recourse" limitation.

Congress almost certainly was aware of this Court's decision in *Awotin* when it reenacted the "without recourse" restriction in 1935.[57] Clearly, Congress then used "without recourse" in its nontechnical sense. At that time Congress was extending the provision to transactions involving "stock," and the phrase in a technical sense would be meaningless in that context because stock necessarily is sold without endorsement or guaranty.[58]

This Court has instructed that the "without recourse" provision should be construed so as to be "consonant with all the different forms of business to which the proviso relates." *Awotin*, 295 U.S. at 211. Technically, "without recourse" implies avoidance of an endorser's or guarantor's risk of liability to third parties. The question, therefore, is what analogous risk of liability to third parties exists in brokerage transactions.

As Congress obviously recognized, there is indeed such a risk. Brokers who execute trades for their customers risk liability to third-party purchasers or sellers for the entire amount of those trades. If their customers fail to deliver funds or securities on the settlement dates, the brokers must make good on the trades and then look to their customers for recovery. This risk, which always exists when the market moves

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57 This Court decided *Awotin* on April 29, 1935, and Congress enacted the 1935 amendment to Section 16 of the Glass-Steagall Act just four months later, on August 23, 1935. Presumed Congressional awareness of judicial constructions is a well-established principle. *E.g.*, *Lorillard* v. *Pons*, 434 U.S. 575, 580 (1978), and authorities cited therein. The doctrine is particularly apt here, where the interpretation involved is this Court's decision construing the *same* language, in the *same* statutory provision that Congress was considering amending at the *same* time the decision was rendered.

58 *See Awotin*, 295 U.S. at 212, where this Court rejected the technical reading of the phrase in that it would not have applied to instruments such as bonds or debentures because they are "usually negotiated without endorsement." (*Id.*) The only answer to the "without recourse" restriction in the Board's ruling (150A-151A n.50) was that the phrase is inapplicable because it means endorsement or guaranty—completely ignoring this Court's flat rejection of that interpretation.

against customers' positions, is magnified enormously in a market turn such as the panic of 1929.[59]

The court below appeared to recognize that "without recourse" was intended to prevent the risk of liability to third parties, and acknowledged the exposure of brokers to claims by third-party purchasers or sellers. The court nevertheless held the statutory requirement to be satisfied because, here, the broker "retains full power to bring actions for breach of contract against customers who fail to pay for or deliver securities." (169A n.4.) This circular reasoning, however, completely misses the point. The issue is not whether a bank may have recourse against its own customers but whether third parties have recourse against a bank at all.[60]

"Without recourse," in a brokerage context, means that risk of liability to third-party purchasers or sellers must be avoided entirely. This can be accomplished by banks' passing orders from their customers along to a broker for execution pursuant to an arrangement under which the broker looks directly to the customer for performance. (*See* J.A. 249-57.) "Liability [to the bank] . . . by way of 'recourse' growing out of the transaction of the business" (*Awotin*, 295 U.S. at 214; citations omitted) is thereby avoided.

This interpretation is consistent with the historical service offered by banks as an accommodation, forwarding their

59 The potential harm to brokers from customer fails was again amply demonstrated during the early 1970s when excessive fails contributed to the demise of a number of major brokerage firms. *See* Securities and Exchange Commission, *Study of Unsafe and Unsound Practices of Brokers and Dealers*, H. Doc. 92-231, 92d Cong., 1st Sess. 1, 19, 96 (1971). While back-office capabilities and practices that then existed have been enhanced, the risk always associated with excessive fails continues to exist.

60 If a right over against customers had been Congress' object, the "without recourse" requirement would have been superfluous, in that an agent always has such a right against its principal. It is fundamental that all terms used by Congress should be given effect. *See, e.g., United States* v. *Menasche*, 348 U.S. 528, 538-39 (1955) ("[i]t is our duty 'to give effect, if possible, to every clause and word of a statute,'. . . rather than to emasculate an entire section, as the Government's interpretation requires") (citation omitted); *Reiter* v. *Sonotone Corp.*, 442 U.S. 330, 339 (1979).

customers' securities orders to brokers for execution. It also reflects the policy underlying the Glass-Steagall Act to bar banks from incurring any risk in connection with speculative securities. Through its restrictions, Congress prohibited banks from underwriting stock and from purchasing it for their own accounts, thereby eliminating any risk to banks as principals. And, furthering the same objective, Congress eliminated any risk to banks in stock brokerage transactions, as agents, by retaining the requirement in Section 16 that all transactions be "without recourse."

In sum, the statutory language, legislative history and precedent of this Court all confirm that banks are strictly limited solely to accommodating their bank customers by forwarding their orders for securities and stock to brokers for execution.

B. The Sections Of The Glass-Steagall Act Should Be Read Consistently To Prohibit Public Securities Brokerage By Bank Affiliates

What is generally known as the "Glass-Steagall Act" comprised four sections (16, 20, 21 and 32) of the Banking Act of 1933, codified at 12 U.S.C. §§ 24, 78, 377 and 378. Together, as amended in 1935, these sections: (1) entirely prohibit banks from engaging *directly* in various securities activities and (2) substantially restrict the ability of banks to engage *indirectly* in these prohibited activities through affiliation or management interlocks with other entities.

Section 16 of the Glass-Steagall Act (177A-178A) provides that member banks of the Federal Reserve System "shall not underwrite any issue of securities or stock" nor purchase any "securities or stock" for its own account unless they are "investment securities" as defined in the statute.[61] 12 U.S.C. § 24 (Seventh). As discussed above, Section 16 also expressly prohibits member banks from "dealing in securities and

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61 Section 16 itself applies directly to national banks, and certain of its restrictions on securities activities are made applicable to state member banks by 12 U.S.C. § 335.

stocks" except where such dealing is "without recourse, solely upon the order, and for the account of, customers." *Id.* Section 21 of the Act (178A-179A), in turn, makes it illegal for all depository institutions to engage in the "business of issuing, underwriting, selling or distributing" securities, except to the extent permitted by Section 16. 12 U.S.C. § 378. These two provisions constitute a bar against any direct bank involvement in the prohibited activities.

Sections 20 and 32 of the Act extend that bar to indirect bank activities. Section 20 (178A) prohibits banks from affiliating with any organization that is "engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes or other securities. . . ." 12 U.S.C. § 377. Section 32 of the Act (179A) prohibits interlocking management relationships between member banks and organizations that are "primarily engaged" in the prohibited activities. 12 U.S.C. § 78.

In short, Congress provided a comprehensive structure governing banks' direct and indirect participation in the prohibited activities. Banks themselves are barred completely from engaging in those activities, and entities related to banks through affiliation or management interlocks are barred from engaging "principally" or "primarily" in them. *Cf.*, *ICI* I, 401 U.S. at 629.

In terms of brokerage, as discussed, the most specific restriction is that of Section 16, which limits a bank activity to "purchasing and selling such securities and stock, without recourse, solely upon the order, and for the account of, customers." (177A.) Section 21, however, also prohibits the "selling" of securities. (178A.) And, although Section 20 does not use the phrase "purchasing and selling" verbatim, it uses the functional equivalent, prohibiting the "public sale" of securities. (*Id.*)

The Board itself elsewhere has urged this Court that "words in the [Glass-Steagall] Act gather meaning from other words in the statute as well as from the underlying legislative pur-

pose."[62] Specifically the Board's counsel, although contending that the proposed acquisition of Schwab is not prohibited, argued before the Administrative Law Judge in these proceedings that the phrases "purchasing and selling" and "public sale," as functional equivalents and parts of a comprehensive statutory scheme, should be construed consistently as encompassing brokerage.[63]

This Court as well has pointed out the congruity of the statutory terms used. In *ICI* I, 401 U.S. at 626 n.12, the Court observed:

> The limitations that the banking laws place on the activities of national banks are at least as great as the limitations placed on the activities of their affiliates. For example, § 32 refers to the "public sale" of stocks or securities while § 21 proscribes the "selling" of stocks and securities.[64]

This approach is consistent with standard rules of statutory construction, which provide that all sections of a statute should be construed consistently.[65]

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62 Brief for the Respondents at 23 n.35, *Securities Industry Ass'n* v. *Board of Governors*, No. 82-1766, *cert. granted*, Oct. 3, 1983.

63 Post-Hearing Brief of Board Counsel at 22-23 (Oct. 1, 1982); J.A. 354-355.

64 Section 32 as initially enacted itself referred to firms primarily engaged in "purchasing, selling or negotiating securities." 48 Stat. 194. This terminology was amended in 1935 to refer to the "issue, flotation, underwriting, public sale, or distribution" of securities, through what were described as "technical amendments." *See* H.R. Rep. 742, 74th Cong., 1st Sess. 2 (1935) ("amendments make no fundamental changes in the existing banking laws"). Plainly, Congress regarded "public sale" and "selling" as equivalent terms.

65 *E.g.*, *Philbrook* v. *Glodgett*, 421 U.S. 707, 713 (1975); *NLRB* v. *Lion Oil Co.*, 352 U.S. 282, 288 (1957) ("In expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy."); *Marine Carriers Corp.* v. *Fowler*, 429 F.2d 702, 706-07 (2d Cir. 1970), *cert. denied*, 400 U.S. 1020 (1971), and authorities cited therein.

Legislative history of the Act also confirms that Congress intended a comprehensive restraint applying both to banks and their affiliates. Opposition to the Act arose in part because of its broad sweep. As argued during debate in the Senate, the sections dealing with the securities activities of banks and bank affiliates are "*interrelated with a single purpose* . . . to sweep away the whole machinery of the investment business of the member banks." 75 Cong. Rec. 1412 (January 9, 1933) (remarks of Sen. Metcalf).[66]

Nothing in the legislative history suggests that the phrase "public sale" in Section 20 was addressed to any narrower range of activities than its functional equivalent "purchasing and selling" used in Section 16. Since the Act was passed, moreover, Congress repeatedly has confirmed its understanding that the activities prohibited similarly reach *both* banks and their affiliates.[67]

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66 These comments were addressed to, *inter alia*, Sections 14 and 18 of S.4412, 72d Cong., 1st Sess. 34, 43 (1932), which became Sections 16 and 20 of the Glass-Steagall Act. As Senator Metcalf further explained (*id.*):

> Section [16] eliminates the investment business as an integral part of a bank, and Section [20] does away with the investment business as a separately incorporated bond department or security affiliate. . . . The Congress should understand thoroughly the sweeping effect which this bill will have upon this phase of banking, and the drastic measures taken to carry out the motives of those responsible for these policies.

67 For example, when considering amendments to the Bank Holding Company Act in 1970 Senator Sparkman, Senate Chairman of the Conference Committee, stressed that bank affiliates could not avoid the Glass-Steagall Act prohibitions on the activities of banks:

> Mr. Williams of New Jersey. I have one question I should like to ask the chairman of the committee. . . . I wonder whether there was any intention to imply that the very securities-related activities forbidden to banks directly may nevertheless be engaged in by bank-holding companies or their nonbanking affiliates.
>
> Mr. Sparkman. The answer to the Senator's question is that there clearly was not. As it now stands, *the Glass-Steagall Act broadly prohibits both banks and their affiliates from engaging in what we commonly understand to be the securities business.*

116 Cong. Rec. 42430 (1970) (emphasis added), *quoted in ICI* II, 450 U.S. at 75 n.55. *See also* S. Conf. Rep. No. 641, 97th Cong., 2d Sess. 92 (1982),

The court below nevertheless reasoned that "the same prohibitions do not apply" to banks and their affiliates under Sections 16 and 20 (168A), citing to this Court's decision in *ICI* II. But, as this Court made clear in *ICI* II, 450 U.S. at 61 n.26 and 64, the difference between the prohibitions of Sections 16 and 20 relates solely to the permitted level of activity allowed to banks as opposed to bank affiliates, not to the substance of those activities. Section 16 bars banks from "engaging" in the prohibited activities to any extent, while Section 20 bars affiliates from engaging "principally" in such activities. The difference between the two sections noted in *ICI* II had nothing to do with the *type* of prohibited activities, but merely with the *degree* of involvement permitted.

Considering Section 20 in isolation, the court below further limited its scope by citing the maxim that words grouped in a list should be construed similarly. The court concluded under this analysis that "public sale" should be restricted by the other terms used in Section 20 ("issue," "flotation," "underwriting," and "distribution"), to include only activities "in which the dealer trades as principal for his own profit." (161A.) Such a conclusion could be justified, however, only if all of the terms being compared with "public sale" were limited solely to principal activities.[68] But, the term "underwriting" as used in Section 20 certainly includes "best efforts" underwriting, which is an agency, not a principal, activity.[69] There is no more

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explaining that authority granted bank subsidiaries in 1982 to engage in activities permitted to holding company affiliates under Section 4(c)(8) would *not* authorize any securities activity prohibited to banks by the Glass-Steagall Act. *Accord* 128 Cong. Rec. S12215 (Sept. 24, 1982) (statement of Sen. Riegle).

68 *See Harrison* v. *PPG Industries, Inc.*, 446 U.S. 578, 588 (1980) (where one of the other terms upon which a statutory construction relies may not connote the argued-for meaning, rule of *ejusdem generis* is inapplicable).

69 "Best efforts" underwriting is where a securities house "instead of *buying* the issue *from* the company and reselling it as principal, *sells* it *for* the company as agent." 1 Loss, *Securities Regulation* 171-172 (2d ed. 1961) (emphasis in original).

reason to construe the term "public sale" to include only principal, and not agency, activities.

Section 21 of the Act also uses the terms "issuing," "underwriting" and "distributing" in conjunction with the term "selling." Yet, plainly "selling" as used in Section 21 encompasses more than just principal activities. The floor manager in the House of the bill that was eventually to become the Glass-Steagall Act specifically described Section 21 as taking "brokers" out of the depository business. (*See*, *supra*, p. 21.) Furthermore, no reason exists to believe that Congress, which prohibited securities brokerage to member banks of the Federal Reserve System under Section 16, did not intend to do the same for non-member banks under Section 21.[70]

The reading given to Section 20 by the court below assumed that Congress intended the statutory terms in a limited, technical meaning. Yet, this Court has repeatedly instructed that the prohibitory terms of this remedial statute are *not* to be construed narrowly or accorded a technical meaning. *ICI* II, 450 U.S. at 65; *ICI* I, 401 U.S. at 635; *Board of Governors* v.

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70 The Board itself has argued to this Court that Sections 16 and 21 should be interpreted as co-extensive. Brief for Respondents at 21, *Securities Industry Ass'n* v. *Board of Governors*, No. 82-1766, *cert. granted* Oct. 3, 1983.

Indeed, a goal of Congress in enacting the Banking Act of 1933, and its 1935 amendments, was to achieve competitive parity between national and state banks. *See* 77 Cong. Rec. 3726 (1933) (remarks of Sen. Glass). It would be incongruous, therefore, if national banks and state-member banks, which are subject to Section 16, were prohibited from securities brokerage, while state non-member banks, which are subject only to Section 21, were not.

The legislative history of the Glass-Steagall Act suggests that separate sections were drafted to deal with national banks, state-member banks of the Federal Reserve System, and state non-member banks due to concern over the extent to which Congress had the constitutional authority to restrain activities of banks chartered by the state legislatures, especially if those banks had not chosen to become members of the Federal Reserve System. *See* S. Rep. No. 584, 72d Cong., 1st Sess. 10 (1933); *see also* 77 Cong. Rec. 3727 (1933) (remarks of Sen. Glass); 77 Cong. Rec. 4179 (1933) (remarks of Sen. Tydings). There is no indication whatsoever in the legislative history that separate sections were drafted so as to restrict different *types* of activities engaged in by these different institutions.

Agnew, 329 U.S. 441, 446-67 (1947); *cf. Awotin* v. *Atlas Exchange National Bank*, 295 U.S. 209, 212 (1935).

Moreover, if Congress had intended to use statutory terms in their technical sense, presumably it would have done that throughout the Act; it did not do so. The term "dealer," for example, technically refers to someone who is acting in the capacity of a principal.[71] Section 16 of the Act, however, describes "the business of *dealing* in securities and stock," as purchasing and selling securities "upon the order, and for the account of customers," obviously referring to agency, not principal, activities. Congress used "dealing" in its broad, generic sense. There is no reason to believe Congress intended to use other terms in the Glass-Steagall Act in a technical, commercial sense.

The court below also sought support for its holding in *Board of Governors* v. *Agnew*, 329 U.S. 441 (1947), concluding that this Court implicitly had determined the present issue in that action. *Agnew*, however, was a case concerning Section 32 of the Act, in which this Court did not, and did not have to, address the question of whether brokerage activities are prohibited for banks, or whether the term "public sale" should be construed consistently with the term "purchasing and selling" used elsewhere in the Act. Assuming that Section 32 covered the "underwriting" field, 329 U.S. at 445 n.3, this Court found a sufficient level of prohibited conduct to satisfy the "primarily engaged" standard of the Act there at issue.[72]

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71 *See*, 15 U.S.C. § 78c(a)(5) ("dealer" defined as one who buys and sells for his own account). As the Board put it in its Order, "[a] dealer is thus unlike a broker, which acts for the account of its customer." (148A n. 41.)

72 The court below also cited (162A) the pre-*Agnew* Board interpretation of Section 32 as excluding brokerage activities, to support its narrow reading of Section 20. 22 Fed. Res. Bull. 51 (1936). There is no reason, however, why only two sections of the Act (20 and 32) should be viewed in isolation from the remaining sections (16 and 21) when ascertaining Congressional intent. Moreover, in marked contrast to the Comptroller's contemporaneous construction of Section 16 of the Act (*see, supra*, pp. 22-25), there is no indication that the Board's construction of Section 32 was ever brought to Congressional attention, let alone that it led to Congressional action. Nor

Here, by contrast, the types of activities prohibited by the Glass-Steagall Act *are* at issue and, as noted in *ICI* II, 450 U.S. at 63, these include the activities of both "underwriters" and "brokerage houses." This Court certainly did not rule in *Agnew* that bank affiliates may engage *principally* in activities that are prohibited *entirely* for banks—the holding of the court below in this case.

The Court of Appeals did not cite *Agnew*, or for that matter any other case, in support of its holding in the latter respect. The court's rationale (168A) was as follows:

> We think, however, that the latitude the Act grants bank holding companies partially to engage in activities such as underwriting, which implicate the Act's policies whether conducted by banks or bank holding companies, suggests that bank holding companies can, under the Act, be allowed principally to engage in activities which pose the dangers the Act addressed only when conducted by banks.

No citation accompanied this holding because there is no precedent to support it. This marks the first time any court has ruled that the coverage of Section 20 depends, not simply upon whether the affiliate is engaged "principally" in activities prohibited by the Act, but upon an assessment of whether the activities involved "pose the dangers the Act addressed."

By this holding, the court effectively vested in the Board exemptive authority under Section 20 that Congress itself has withheld.[73] In marked contrast to Section 32 of the Act, which

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does, or could, anything suggest how the Board's interpretation furthered the underlying Congressional intent to separate banks from transactions in speculative securities. Like the administrative interpretation in *Zuber* v. *Allen*, *supra*, 396 U.S. at 193, the Board's Section 32 interpretation lacks those "props that serve to support a disputable administrative construction."

73 In adopting the Glass-Steagall Act Congress did consider, and reject, proposals merely to regulate, rather than prohibit, bank involvement in the securities business. *See* Willis and Chapman, *The Banking Situation* 68-69 (1934). At the urging of the Comptroller of the Currency and others Congress also considered a number of amendments to the Act during 1934-35, including proposals that were rejected which would have replaced

does permit the Board to exempt certain arrangements from the Act's management interlock provisions,[74] Section 20 vests no exemptive authority whatsoever in the Board to authorize prohibited securities activities for bank affiliates.[75]

In sum, public securities brokerage is among the prohibited activities covered by the Glass-Steagall Act. Banks therefore are prohibited from engaging in that activity at all and from affiliating with any organization principally engaged in it. For this reason, too, the decision below should be reversed.

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the Act's prohibitions with regulatory authority. *E.g.*, S. Rep. No. 1007, 74th Cong., 1st Sess. 16 (1935). *See Generally* Brief of the Securities Industry Association at 22-25, *Securities Industry Ass'n.* v. *Board of Governors*, No. 82-1766, *cert. granted*, Oct. 3, 1983.

74 Section 32, 12 U.S.C. § 78, excepts:

> limited classes of cases in which the Board of Governors of the Federal Reserve System may allow such service by general regulations when in the judgment of the said Board it would not unduly influence the investment policies of such member bank or the advice it gives its customers regarding investments.

75 The observation of the *National Courier* court, 516 F.2d at 1241, concerning application of the Bank Holding Company Act, under which the Board has some discretion, applies *a fortiori* to Section 20 of the Glass-Steagall Act, under which the Board has none:

> Congress did not instruct the Board to allow or disallow bank involvement in nonfinancial activities as may be required by the policies which counsel a separation of commerce and banking. Having heeded that counsel itself, it decreed a separation and instructed the Board to enforce it.

The court's analysis of Section 20 also disregards Congress' concern that affiliate losses and financial difficulties can "discredit the bank and impair the confidence of its depositors." 75 Cong. Rec. 9912 (1933) (remarks of Sen. Bulkley) *quoted in ICI* I, 401 U.S. at 632 n.26. This concern remains real, as underscored by recent testimony of Walter Wriston, Chairman of Citicorp, before the Senate Banking Committee:

> [I]t is inconceivable that any major bank would walk away from any subsidiary of its holding company. If your name is on the door, all of your capital is going to be behind it in the real world. Lawyers can say you have separation, but the marketplace is persuasive, and it would not see it that way.

Hearings on S.1686, S.1703, S.1720 & S.1721 Before Senate Comm. on Banking, Housing and Urban Affairs, 97th Cong., 1st Sess., Pt. II at 589-590 (1981).

III.

THE DECISION BELOW IMPROPERLY DEFERS TO AGENCY AMENDMENT OF LEGISLATIVE POLICY

The Court of Appeals defined its task as simply determining whether the Board's statutory interpretation was "reasonable." (160A.) The Court so limited its inquiry even though the Board has *no* rulemaking authority under relevant provisions of the Glass-Steagall Act,[76] and even though the Board's decision involves "the quintessential judicial function of deciding what a statute means."[77]

The matters at issue involve questions of law: the proper construction of the Glass-Steagall Act, and the correct meaning of the Bank Holding Company Act.[78] The courts have the "ultimate responsibility to construe the language employed by Congress,"[79] and "deference owed to an expert tribunal cannot be allowed to slip into a judicial inertia which results in the unauthorized assumption by an agency of major policy decisions properly made by Congress."[80] As this Court recently

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76 *Cf. General Electric Co.* v. *Gilbert*, 429 U.S. 125, 141-42 (1976).

77 *Bureau of Alcohol, Tobacco & Firearms* v. *Federal Labor Relations Authority*, ___ U.S. ___, 104 S. Ct. 439, 444-45 n.8 (1983). *See also Commissioner* v. *Engle*, 52 U.S.L.W. 403, 409 (U.S. Jan. 10, 1984); *Barlow* v. *Collins*, 397 U.S. 159, 166 (1970). The Administrative Procedure Act, of course, directs that agency action is to be set aside by the courts wherever it is found to be "not in accordance with law". 5 U.S.C. § 706(2)(A).

78 *See National Courier Association* v. *Board of Governors*, 516 F.2d 1229, 1236 (D.C. Cir. 1975) (construction of phrase "closely related" is a legal issue for the court to decide).

79 *Zuber* v. *Allen*, *supra*, 396 U.S. at 193; *See NLRB* v. *Brown*, 380 U.S. 278, 291-92 (1965).

80 *Bureau of Alcohol, Tobacco & Firearms* v. *Federal Labor Relations Authority*, *supra*, 104 S. Ct. at 444 *quoting American Ship Building Co.* v. *NLRB*, 380 U.S. 300, 318 (1965). *See also International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551, 566 & n.20 (1979).

stressed, policy determinations "must be implemented by Congress and not by a crabbed [administrative] interpretation of the words of the statute."[81] *BankAmerica Corporation* v. *United States*, ____ U.S. ____, 103 S. Ct. 2266, 2273 (1983).

The Board here sanctioned an unprecedented "[e]xpansion of banking into securities activities" (155A), unquestionably a major policy decision. This administrative "expansion" is especially significant because Congress itself is considering legislative proposals to revise existing statutory restrictions on financial institutions.[82] In each of several recent sessions Congress has enacted major revisions of the federal banking laws,[83]

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81 This is especially true with respect to the interrelated statutory structure governing financial institutions, which has been disrupted substantially by recent piecemeal administrative alterations. The entry of banks into brokerage thus has forced the Securities and Exchange Commission, in the interest of investor protection, to propose rules extending its jurisdiction over banks that "publicly solicit brokerage business." 48 Fed. Reg. 51,930 (Nov. 15, 1983). The American Bankers Association has challenged the power of the SEC to adopt the proposed rule. 42 Wash. Fin. Rep. (BNA), No. 2 at 76 (Jan. 9, 1984).

Similarly, after the Board acted to exempt commercial paper from the definition of "security" as used in the Glass-Steagall Act, 46 Fed. Reg. 29333 (June 1, 1981), the Federal Energy Regulatory Commission and the Securities and Exchange Commission were each required to issue temporary exemptions from interrelated provisions in the statutes they administer. *See* 46 Fed. Reg. 19980 (April 2, 1981); 46 Fed. Reg. 18535 (March 25, 1981).

82 *See, e.g.*, Financial Institutions Deregulatory Act, S. 1609 and H.R. 3537, 98th Cong., 1st Sess. (1983), which would substantially expand existing powers of bank holding companies. In addition to this proposal, Congress currently is considering legislation to revise the federal deposit insurance system, ban the acquisition of banks by non-depository institutions, restructure the federal system for regulating financial institutions and reform the requirements of membership in the Federal Reserve System. *See* 42 Wash. Fin. Rep. (BNA) No. 6 at 261 (Feb. 6, 1984); 41 Wash. Fin. Rep. (BNA) No. 10 at 326 (Sept. 12, 1983).

83 *See* Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 132 (1982); Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (1980); Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3641 (1978).

but in each instance Congress itself has determined not to relax existing restrictions on bank securities activities. To the contrary, Congress repeatedly has reaffirmed its support of existing Glass-Steagall Act restrictions by, for example:

—stressing that new rulemaking authority granted the Comptroller does *not* extend to issuing regulations concerning "securities activities of National Banks under the Act commonly known as the 'Glass-Steagall Act';"[84] and

—confirming that new powers given to bank subsidiaries do *not* authorize "any securities activity that is prohibited to banks or bank holding companies under the Glass-Steagall Act."[85]

Nevertheless, reacting to pressures from the entities they regulate, federal banking agencies have been paring back, slice by slice, the existing statutory limitations. For example, although the Board at present has barred the addition of "investment advice" to discount brokerage (155A), two other bank regulatory agencies have already authorized entities under their supervision to combine brokerage with investment advice.[86] Nor have the recent administrative reinterpretations been lim-

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84 *See* 12 U.S.C. § 93a adopted as part of the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (1980).

85 S. Conf. Rep. 641, 97th Cong., 2d Sess. 92 (1982), commenting on section 709 of the Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 132.

86 *See Decision of the Comptroller of the Currency Concerning an Application by American National Bank of Austin, Texas to Establish an Operating Subsidiary to Provide Investment Advice* (Sept. 2, 1983); *Decision of the Federal Home Loan Bank Board on the Service Corporation Application of Coast Federal Savings & Loan Association, et al.* (May 6, 1982). These decisions are currently subject to challenge before the courts. *See Securities Industry Ass'n* v. *Conover*, No. 83-3581 (D.D.C., filed Nov. 30, 1983); *Securities Industry Ass'n* v. *Federal Home Loan Bank Bd.*, No. 82-1920 (D.D.C. filed July 12, 1982).

ited to brokerage. One bank agency has even ruled that shares in bank-operated collective investment funds do not constitute "securities," and so may be underwritten by banks, despite this Court's contrary holding in *ICI* I.[87]

Much of this has a sense of déjà vu to it. Many of the arguments advanced today to defend regulatory expansion of bank activities echo the contentions of those who proposed the McFadden Act of 1927 in order to permit national banks to deal in investment securities. There, too, it was argued that the banks needed authority "to give the most complete modern banking service" and to compete effectively with other financial institutions.[88] Less than ten years later the economy had collapsed, thousands of banks had failed, and the President had declared a national bank holiday. Congress then removed securities powers included in the McFadden Act. Bank regulators should not now be free to "reinterpret" Congressional actions in a manner that defeats the result intended—removal of banks from the securities business.

The opinion below, if allowed to stand, will signal to the lower federal courts and to other bank regulators that the "[e]xpansion of banking into securities activities" (155A) may continue apace, without any Congressional action on the fundamental policy changes being implemented. It should be reversed.

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87 *Decision of the Comptroller of the Currency on the Application by Citibank to Establish Common Trust Funds for the Collective Investment of Individual Retirement Account Trusts* (October 28, 1982).

88 H.R. Rep. No. 583, 68th Cong., 1st Sess. 1 (1924); *see* 67 Cong. Rec. 2845 (1926).

CONCLUSION

For each and all the reasons set forth above, the decision of the Court of Appeals should be reversed, and the case remanded with directions to vacate the Board's Order of January 7, 1983 as null and void and to direct respondent BAC to divest itself of Schwab.

Dated: March 6, 1984

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